The decrees below are

Affirmed.

MARR *v.* UNITED STATES.

APPEAL FROM THE COURT OF CLAIMS.

No. 236. Argued November 19, 1924; restored to docket for reargument January 5, 1925; reargued March 12, 1925.—Decided June 1, 1925.

A Delaware corporation, organized for the purpose, took over the assets and continued the business of a New Jersey corporation, assuming its liabilities, after an exchange of stock, as follows: The New Jersey corporation had outstanding \$15,000,000 of 7% preferred and \$15,000,000 common stock, all shares of the par value of \$100, and had accumulated a large surplus from profits,

the actual value of the common stock being $842.50 per share; the Delaware corporation had an authorized capital of $20,000,000 in 6% non-voting preferred stock and $82,600,000 in common, shares all of the par value of $100, and exchanged five shares of its common stock for every like share in the New Jersey corporation, and one and one-third shares of its preferred stock for every like share in the New Jersey corporation, making payments in cash to avoid fractional certificates; and thus all the stock of the New Jersey corporation was exchanged, except a few shares of preferred stock redeemed in cash, and the Delaware corporation had $7,600,000 of authorized common stock remaining which was sold or held for sale for additional capital. *Held* that the new securities thus received by an old stock-holder were not in effect a stock dividend; and that their value above the cost of his exchanged securities, bought by him prior to March 1, 1913, was taxable as income under the Act of September 8, 1916, and within the power of Congress so to tax, since the corporations were essentially different, being organized in different States and with different rights and powers, and since the shares exchanged represented different interests both because of these differences in the corporations and because a 6% non-voting preferred stock differs essentially from a 7% voting preferred stock, and common stock subject to the priority of $20,000,000 preferred and a $1,200,000 annual dividend charge differs essentially from a common stock subject only to $15,000,000 preferred and a $1,050,000 annual dividend charge. *Eisner* v. *Macomber,* 252 U. S. 159, and *Weiss* v. *Stearn,* 265 U. S. 242, distinguished. P. 539.

58 Ct. Cl. 658, affirmed.

Appeal from a judgment rendered by the Court of Claims for the United States in a suit brought by the appellant to recover the amount of an additional income tax paid under protest.

Mr. William L. Frierson, for appellant.

The Solicitor General, with whom *Messrs. Nelson T. Hartson* and *Chester A. Gwinn* were on the brief, for the United States.

Messrs. James Byrne and *Arthur A. Ballantine* submitted a brief as *amici curiae,* by special leave of Court.

MR. JUSTICE BRANDEIS delivered the opinion of the Court.

Prior to March 1, 1913, Marr and wife purchased 339 shares of the preferred and 425 shares of the common stock of the General Motors Company of New Jersey for $76,400. In 1916, they received in exchange for this stock 451 shares of the preferred and 2,125 shares of the common stock of the General Motors Corporation of Delaware which (including a small cash payment) had the aggregate market value of $400,866.57. The difference between the cost of their stock in the New Jersey corporation and the value of the stock in the Delaware corporation was $324,466.57. The Treasury Department ruled that this difference was gain or income under the Act of September 8, 1916, c. 463, Title I, §§ 1 and 2, 39 Stat. 756, 757; and assessed, on that account, an additional income tax for 1916 which amounted, with interest, to $24,-944.12. That sum Marr paid under protest. He then appealed to the Commissioner of Internal Revenue by filing a claim for a refund; and, upon the disallowance of that claim, brought this suit in the Court of Claims to recover the amount. Judgment was entered for the United States. 58 Ct. Cl. 658. The case is here on appeal under § 242 of the Judicial Code.

The exchange of securities was effected in this way. The New Jersey corporation had outstanding $15,000,000 of 7 per cent. preferred stock and $15,000,000 of the common stock, all shares being of the par value of $100. It had accumulated from profits a large surplus. The actual value of the common stock was then $842.50 a share. Its officers caused to be organized the Delaware corporation, with an authorized capital of $20,000,000 in 6 per cent. non-voting preferred stock and $82,600,000 in common stock, all shares being of the par value of $100. The Delaware corporation made to stockholders in the New

Jersey corporation the following offer for exchange of securities: For every share of common stock of the New Jersey corporation, five shares of common stock of the Delaware corporation. For every share of the preferred stock of the New Jersey corporation, one and one-third shares of preferred stock of the Delaware corporation. In lieu of a certificate for fractional shares of stock in the Delaware corporation payment was to be made in cash at the rate of $100 a share for its preferred and at the rate of $150 a share for its common stock. On this basis all the common stock of the New Jersey corporation was exchanged and all the preferred stock except a few shares. These few were redeemed in cash. For acquiring the stock of the New Jersey corporation only $75,000,000 of the common stock of the Delaware corporation was needed. The remaining $7,600,000 of the authorized common stock was either sold or held for sale as additional capital should be desired. The Delaware corporation, having thus become the owner of all the outstanding stock of the New Jersey corporation, took a transfer of its assets and assumed its liabilities. The latter was then dissolved.

It is clear that all new securities issued in excess of an amount equal to the capitalization of the New Jersey corporation represented income earned by it; that the new securities received by the Marrs in excess of the cost of the securities of the New Jersey corporation theretofore held were financially the equivalent of $324,466.57 in cash; and that Congress intended to tax as income of stockholders such gains when so distributed. The serious question for decision is whether it had power to do so. Marr contends that, since the new corporation was organized to take over the assets and continue the business of the old, and his capital remained invested in the same business enterprise, the additional securities distributed were in legal effect a stock dividend; and that under the rule of *Eisner* v. *Macomber,* 252 U. S. 189, applied in

Weiss v. *Stearn*, 265 U. S. 242, he was not taxable thereon as income, because he still held the whole investment. The Government insists that identity of the business enterprise is not conclusive; that gain in value resulting from profits is taxable as income, not only when it is represented by an interest in a different business enterprise or property, but also when it is represented by an essentially different interest in the same business enterprise or property; that, in the case at bar, the gain actually made is represented by securities with essentially different characteristics in an essentially different corporation; and that, consequently, the additional value of the new securities, although they are still held by the Marrs, is income under the rule applied in *United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176; and *Cullinan* v. *Walker*, 262 U. S. 134. In our opinion the Government is right.

In each of the five cases named, as in the case at bar, the business enterprise actually conducted remained exactly the same. In *United States* v. *Phellis*, in *Rockefeller* v. *United States* and in *Cullinan* v. *Walker*, where the additional value in new securities distributed was held to be taxable as income, there had been changes of corporate identity. That is, the corporate property, or a part thereof, was no longer held and operated by the same corporation; and, after the distribution, the stockholders no longer owned merely the same proportional interest of the same character in the same corporation. In *Eisner* v. *Macomber* and in *Weiss* v. *Stearn*, where the additional value in new securities was held not to be taxable, the identity was deemed to have been preserved. In *Eisner* v. *Macomber* the identity was literally maintained. There was no new corporate entity. The same interest in the same corporation was represented after the distribution by more shares of precisely the same character. It was as if the par value of the stock had been

reduced, and three shares of reduced par value stock had been issued in place of every two old shares. That is, there was an exchange of certificates but not of interests. In *Weiss* v. *Stearn* a new corporation had, in fact, been organized to take over the assets and business of the old. Technically there was a new entity; but the corporate identity was deemed to have been substantially maintained because the new corporation was organized under the laws of the same State, with presumably the same powers as the old. There was also no change in the character of securities issued. By reason of these facts, the proportional interest of the stockholder after the distribution of the new securities was deemed to be exactly the same as if the par value of the stock in the old corporation had been reduced, and five shares of reduced par value stock had been issued in place of every two shares of the old stock. Thus, in *Weiss* v. *Stearn,* as in *Eisner* v. *Macomber,* the transaction was considered, in essence, an exchange of certificates representing the same interest, not an exchange of interests.

In the case at bar, the new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey. Because of these inherent differences in rights and powers, both the preferred and the common stock of the old corporation is an essentially different thing from stock of the same general kind in the new. But there are also adventitious differences, substantial in character. A 6 per cent. non-voting preferred stock is an essentially different thing from a 7 per cent. voting preferred stock. A common stock subject to the priority of $20,000,000 preferred and a $1,200,000 annual dividend charge is an essentially different thing from a common stock subject only to $15,000,000 preferred and a $1,050,000 annual dividend charge. The case at bar is not one in which after the

distribution the stockholders have the same proportional interest of the same kind in essentially the same corporation.

Affirmed.

The separate opinion of MR. JUSTICE VAN DEVANTER, MR. JUSTICE MCREYNOLDS, MR. JUSTICE SUTHERLAND and MR. JUSTICE BUTLER.

We think this cause falls within the doctrine of *Weiss* v. *Stearn*, 265 U. S. 242, and that the judgment below should be reversed. The practical result of the things done was but the reorganization of a going concern. The business and assets were not materially changed, and the stockholder received nothing actually severed from his original capital interest—nothing differing in substance from what he already had.

Weiss v. *Stearn* did not turn upon the relatively unimportant circumstance that the new and old corporations were organized under the laws of the same State, but upon the approved definition of income from capital as something severed therefrom and received by the taxpayer for his separate use and benefit. Here stockholders got nothing from the old business or assets except new statements of their undivided interests, and this, as we carefully pointed out, is not enough to create taxable income.

UNITED STATES v. GULF REFINING COMPANY.

tion or not does not in the mind of anyone, courts, legislators, lawyers or business men depend upon whether the new corporation is organized under the same state as the old or under a foreign state. No such distinction has ever been taken in Congress, in the Income Tax Bureau or in the decisions of this Court.

(*a*) Congress said in the Revenue Act of 1921 that reorganization includes "recapitalization or mere change in identity, form or place of organization of a corporation (however effected)."

(*b*) The Income Tax Bureau has never made the question of whether or not there was a real sale or there was taxable gain depend upon whether the new corporation was a foreign or domestic one. In A. R. R. 16 (3-20-697), June, 1920; Cumulative Bulletin, page 312, *a corporation reincorporated in another state* and stock of the old corporation was exchanged for stock of the new, share for share of equal par value. The Committee said: "The change of domicile took place in 1916, and the Committee has considered a number of precedents established under the acts of 1913 and 1916, with regard to the treatment of essentially similar transactions * * * *It also finds that in numerous cases it was held that no income accrued to the stockholders by reason of exchange of their stock in the old for stock in the new corporation.*"

(*c*) This court has twice decided in income tax cases, *Southern Pacific Co.* v. *Low*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Llewellyn*, 248 U. S. 71 (cited as authorities in the *Acme* case) that corporations (which were organized under the laws of different States), while "distinct beings in contemplation of law", were in substance identical. In the

first case, the Southern Pacific Company, a corporation of Kentucky, owned all the capital stock of the Central Pacific, a corporation of the State of Utah. The Utah corporation declared a dividend, but the court held that though the two companies were separate legal entities they were in fact merged and therefore the thing which was a dividend in form, in substance was not. The same thing was held in *Gulf Oil Corporation* v. *Llewellyn*, 248 U. S. 71. The District Court had found (245 Fed. Rep. 1, pp. 2-3) that the Gulf Oil Corporation was a holding company of New Jersey and that it was the owner of all the capital stock except directors' qualifying shares of the J. M. Guffey Petroleum Company, the Gulf Pipe Line Company, the Gulf Pipe Line Company of Oklahoma and the Indiana Oil & Gas Company. As a matter of fact the subsidiary companies were none of them corporations of the same state as the holding company, as was quite apparent from the names of some of them. The subsidiary companies declared dividends which were paid to the holding company not in cash but by taking over debtor and creditor accounts existing among the subsidiary corporations. The Circuit Court of Appeals said, page 6:

> "* * * each of the companies, whether holding or subsidiary, is a distinct entity and is to be so treated. The several companies are not in such relations to each other that the property and obligations and liabilities of one can be regarded as the property and obligations and liabilities of any other. Each owns its own assets, carries on its own business, owes its own debt, pays its own taxes and enjoys its own income."

It followed, therefore, in the opinion of that court, that a dividend had been declared by the sub-

sidiaries, that it had been received by a corporation which was a distinct entity and therefore the corporation receiving the dividend had received taxable income. The Supreme Court reversed this ruling and held that though in contemplation of law the subsidiaries were distinct beings from the petitioner the forms gone through should be disregarded and the dividends not considered as income. In other words, although corporations are, to use the language of Mr. Justice Holmes in the *Gulf Oil Company* case, "distinct beings in contemplation of law", they may be in substance the same, and that, too, whether they are corporations of the same or different states. In other words there may be such a relationship between corporations of the same or different states that what is in form a dividend is in substance not. On the same principle there can be such a relationship between corporations whether of the same or different states that what in form is a sale or exchange of stock in substance is not.

IV.

The theories and practice and rulings of the Income Tax Bureau in cases of reorganization have been for years contradictory and confusing. This is because the Bureau refused to follow in all cases of reorganization the principles of the stock dividend decisions.

We have three periods in the practice of the Bureau:

(*a*) A period when the Bureau held taxable gain did not arise from a stock dividend or from a reorganization;

> (*b*) a period when it held taxable gain did arise from a stock dividend and held as a consequence that taxable gain did arise from a reorganization.

Then came *Towne* v. *Eisner,* 245 U. S. 418 (Jan. 7, 1918), and *Eisner* v. *Macomber* (March 8, 1920) and in consequence

> (*c*) a period when the Bureau held that no taxable gain arose from a stock dividend. To be logical and consistent the Bureau in period (*c*) should have held and should now hold that no taxable gain arises from a reorganization. This the Bureau in some cases does and in others does not.

It makes a distinction between the case where the exchange is share for share and where the exchange is one share for several shares. It says that when A receives for one share of stock which cost him $30 five shares of stock in a new company of a market value of $600 (whether the new company is foreign or domestic), A makes $570 profit, but when B on the same day receives for one share of stock in an old company which cost him $30 *one* share of stock of a new company of a market value of $600, he makes no profit (whether the new company is foreign or domestic).

Such a distinction, we submit, is entirely without reason. But it will continue to be taken by the Bureau until this case is decided in favor of the appellant.

V.

A rule to decide whether any transaction is a change, not in substance but only in form, may be found, we suggest, in this:

To determine whether or not in any case taxable income has been received, find out whether what has been done could have been done in another way, which admittedly would not have produced taxable income. In other words if there are two methods of producing one thing from another and the product in one case is not taxable it is not taxable in the other. The product is the substance and that is identical. The method is the form and that is different.

What we start with is a company having a certain amount of common stock; what we come out with is a company having five times that amount of common stock, each holder of one share of stock in the old company ending up with five shares of stock of the new company, and the new company having the assets of the old company.

Is there any way in which this result might have been obtained so that under the decisions of the Supreme Court and the rulings of the income tax office the stockholder does not receive taxable income? Yes, as follows:

(1) The old company could have declared a stock dividend of four hundred per cent.; each holder of one share would thereafter have been the holder of five shares of the old company. There would have been no taxable income. *Eisner* v. *Macomber*.

(2) The holders of the stock of the old company could then have exchanged their stock share for share for stock of the new company without

having received taxable income. A. R. R. 16 (3-20-697), June, 1920, Cumulative Bulletin, page 312.

Another method:

(1) The old corporation could have exchanged its stock, share for share, for the stock of the new corporation.

(2) The new corporation could then have declared a stock dividend. *Eisner* v. *Macomber*.

VI.

So far, in order to present the question clearly, we have left the question of preferred stock out of the case altogether and have assumed that both the old and the new company had nothing but common stock and there was merely an exchange of stock of the old company and stock of the new company at the rate of one share for five.

The facts are that the old company had 7% preferred stock and the new company 6% preferred stock and the old preferred was exchanged for the new at the rate of three shares for four.

This does not alter the fact at all that there was not a sale but a readjustment of the interests of the parties. The only effect is that the common stockholder has given up some slight interest in the assets. In other words he has *lost* something by the exchange, not *gained* anything.

We must look at the substance not the form of the transaction. Suppose no new company had been formed, but that all the stockholders of the old company had agreed that the rights of the parties should be readjusted and that each preferred stockholder should receive four shares of preferred 6% stock for every three shares of

preferred 7% stock that he had previously owned. Surely whatever may have been the case with the preferred stockholder, there could be no claim that by such a readjustment of interest the common stockholder had realized any income. Let it be assumed that the four shares of 6% preferred stock were more valuable than the three shares of the 7% preferred and that therefore the preferred shareholders had made something which should be taxable. There was nothing gained by the common stockholder who had simply retained his shares and therefore nothing on which he could be taxed. Apply the test which we have already referred to of what is a matter of form as distinguished from a matter of substance. It is certain that the following procedure could have been taken without any taxable income being realized.

(1) The charter of the old company could have been amended so as to allow four shares of new 6% to be given for three shares of old 7%, and the exchange could have been made.

(2) A stock dividend could have been declared of 400% by the old company and each holder of a share of stock of the old company would have become the holder of five shares of stock of that company; no taxable income. *Eisner* v. *Macomber.*

(3) The shares of the old company could have been exchanged dollar for dollar for shares of the new company; no taxable income.

LAST POINT.

The result of the *Acme* case is not merely that under the facts of that case within the meaning of the Revenue Act of 1916 there was no income, but that any act saying there was would be unconstitutional. The court says that it adopts the ruling of the courts below that each old stockholder sold half of his stock for cash "and exchanged the remainder *without gain* for the same proportionate interest in the transferred corporate assets and business". If there was not gain any act attempting to say there was gain and taxing it would be unconstitutional. "* * * when applying the provisions of the Sixteenth Amendment and income laws enacted thereunder we must regard matters of substance and not mere form." "* * * We cannot conclude that mere change for purposes of reorganization in the technical ownership of an enterprise under circumstances like those here disclosed followed by issuance of new certificates constitutes gain separated from the original capital interest. Something more is necessary—something which gives the stockholder a thing really different from what he theretofore had."

Respectfully submitted,

JAMES BYRNE,
ARTHUR A. BALLANTINE,
Amici Curiæ.

END

OF

CASE